

**BILL #** SB 1545

**TITLE:** sales tax; contractors; owner builders

**SPONSOR:** Cheuvront

**STATUS:** As Amended by Senate FIN

**PREPARED BY:** Brian Cary

## **FISCAL ANALYSIS**

### **Description**

The bill would exclude property owners that hire contractors to make improvements on the property from being classified as prime contractors. The bill would allow property owners who were classified under current law as prime contractors for TPT purposes and meet certain provisions to apply for tax refunds retroactive to January 8, 1991. These requests for refunds would be required to be filed from January 1, 2006 through December 31, 2007. The cumulative amount of refunds available to all taxpayers under this provision is limited to a maximum amount of \$10,000, including any applicable interest. Refund claims filed before December 31, 2006 would not be subject to the \$10,000 cap. The bill would repeal the owner builder transaction privilege tax (TPT) classification as of January 1, 2008.

### **Estimated Impact**

The bill is not anticipated to have a substantial fiscal impact, but it will ultimately depend on several factors. The impact will be affected by the number of property owners being classified as prime contractors in the process of making additional improvements to a property that has already been improved by another prime contractor. Several business community representatives suggest that this particular circumstance of property owners being classified as prime contractors does not occur often.

The fiscal impact of the bill will also depend on the current level of compliance with a private taxpayer ruling concerning the classification of property owners as prime contractors. A September 2005 Department of Revenue (DOR) private taxpayer ruling applies to a single case where a property owner was classified a prime contractor, which increased the property owner's liability. To the extent that other property owners have conformed to this ruling, the bill would serve to reduce current collections. If this private taxpayer ruling has not gained wide applicability, the bill is more likely to have a limited fiscal impact.

The bill may also result in a loss of General Fund revenue if refunds are filed. Cumulative refunds are capped at \$10,000 for any claims filed during calendar year 2007, but are unlimited for any claims filed before December 31, 2006.

DOR did not provide an estimate of the bill's fiscal impact.

### **Analysis**

#### *Modification of Prime Contractor Definition to Exclude Property Owners Meeting Certain Conditions*

It is common practice for a property owner to hire a prime contractor to construct a building or make other property improvements. The prime contractor may employ other subcontractors, but the prime contractor is subject to the TPT under the contracting classification. Typically, the prime contractor will receive cash payments periodically and pay tax on 65% of the gross proceeds of the contract.

The property owner may agree to a contract to sell the property to another party. The purchaser and the original property owner may agree for the original owner to make additional improvements to the property prior to when legal title to the property passes to the new owner. In a recent ruling, DOR has interpreted current law as requiring the original owner to be designated the prime contractor as soon as the sales contract is made, whether or not legal title has passed to the new owner. As such, the original owner would be taxed as a prime contractor on the gross proceeds of the sale when it is consummated.

In this particular case, the owner noted that the original prime contractor had already made some TPT payments during construction. By having to pay the prime contractor sales taxes on the gross proceeds (including both original construction and improvements), the owner contended that their share of the gross proceeds related to new construction double-counted the original prime contractor's sales tax payments. DOR ruled that the owner was legally acting as the prime contractor after the sales contract with the buyer was executed and therefore liable for the tax on the gross proceeds of the contract. While the original prime contractor then became a subcontractor and at that point had no further prime contracting tax liability, state law does not provide a mechanism for the owner to receive a refund for taxes already paid by the original prime contractor.

In this scenario, SB 1545 would exclude property owners from being classified as prime contractors, regardless of whether a contract for sale has been executed, retroactive to January 8, 1991. If the property title has already passed to the new owner, the original owner may be considered a prime contractor if they agree to make additional improvements or modifications on behalf of the new owner, since these changes were not covered by the original prime contractor's TPT payments. If property owners have adapted their practices to conform to the DOR ruling, the bill could result in a reduction in TPT revenue. If the ruling has not significantly affected current practices, the bill is likely to have a limited fiscal impact.

#### *Refund Provision*

The bill provides for refund claims to be made, retroactive to January 8, 1991, for TPT payments that were made in excess of what SB 1545 would require. The cumulative amount of the refunds available to all taxpayers is capped by the bill at \$10,000 with a deadline of December 31, 2007 for making additional claims. The actual amount of refunds could be more than \$10,000. The bill specifically excludes refund claims that were filed prior to December 31, 2006 from the \$10,000 limit, and the potential amount of claims affected by this exclusion is unknown.

#### *Owner Builder Classification Repeal*

Under current law, a property owner may obtain a TPT license under the owner builder classification. If the property is sold within 2 years after construction is substantially completed, the owner builder is taxed as a prime contractor on 65% of the gross proceeds of the sale, minus the fair market value of any land included and a few other miscellaneous deductions. The gross proceeds would not only include the materials and labor costs incurred by the contractor, but it also would include any profit margin above those costs. If the property is not sold within 2 years after construction is substantially completed, the owner builder is liable only for the TPT on the retail cost of the materials used. If an owner builder makes additional improvements to a property within 24 months after it is substantially completed, they are liable for the TPT on the cost of those improvements.

The bill would eliminate the owner builder classification. In FY 2006, the General Fund received \$2.7 million from the owner builder classification. Under the bill, taxpayers will essentially continue to pay this liability under other TPT classifications.

#### **Local Government Impact**

TPT revenues are shared with local governments and any reduction in these collections would result in decreased funding for cities and counties. The potential amount of shared local revenue that would be affected by the bill cannot be determined.

2/20/07